

Introduction

The hospTrends Featured Topic this quarter is a look at the components of operating expense. The Featured Topic is where a financial or utilization category is given a slightly longer explanation. hospTrends normally reviews the previous 12 quarters which equals three years plus the current quarter, but in this report we will look at the 10 previous years of quarterly data plus the four quarters of 2005. To be consistent we use quarterly data for the entire time period even though actual fiscal year end data is available through 2004. Our web site information and a short description of the data we have available on our site are at the end of the report.

Quarterly Quick Review

Below is a table summary of the statewide trends. The percentage increase in the total number of discharges was much higher than in the recent past and was the largest one year jump of the 11 years covered in this report. Patient days had its largest percentage increase since 2001. Average length of stay was shorter than any year since 1998 though there is not a great variation from year to year in the ratio. The operating revenue grew at a slightly faster rate than operating expense so operating margin grew by 70.4% over the previous period. Operating expense grew by 7.8% which is within the annual percentage change range of the past 10 years which includes a low of 7.5% and a high of 10.9%. Charity care continues its strong growth while bad debt is actually declining.

Statewide Summary of Quarterly Reports

	4 Quarter Period Ending		Percent	2005 Percent
	Dec-31-2004	Dec-31-2005	Difference	of Tot Rev
Discharges	525,833	543,255	3.3%	
Patient Days	2,266,116	2,319,174	2.3%	
Average Length of Stay	4.31	4.27	-0.9%	
+ Total Revenue	18,889,908,182	21,384,645,565	13.2%	
- Deductions from Revenue	9,590,683,237	11,176,874,226	16.5%	52.3%
= Net Revenue	9,299,224,945	10,207,771,339	9.8%	47.7%
+ Other Operating Revenue	605,684,083	651,575,366	7.6%	3.0%
= Operating Revenue	9,904,909,028	10,859,346,705	9.6%	50.8%
- Operating Expenses	9,612,562,750	10,361,274,133	7.8%	48.5%
= Operating Margin	292,346,278	498,072,572	70.4%	2.3%
+ Other Income/Tax Revenue	136,019,098	112,515,046	-17.3%	0.5%
= Total Margin	428,365,376	610,587,618	42.5%	2.9%
Charity Care	408,333,040	521,326,284	27.7%	2.4%
Bad Debt	451,769,126	435,063,325	-3.7%	2.0%
Operating Margin	2.95%	4.59%	55.4%	
Total Margin	4.27%	5.57%	30.4%	

Featured Topic

A brief explanation of hospital operating expenses

Hospital operating expenses are the actual dollars expended by the hospital in its operations. These operating costs not only include expenses directly involved in running the hospital but also expenses from in-house clinics, free standing clinics, certain physician salaries and other health care services operated by the hospital. Even though hospitals are expensive buildings with expensive equipment and services that use expensive supplies, overall operating expenses are still driven by salary and benefits. This "people" expense

has been more than half of operating expenses since we began collecting data in 1975. Remarkably, the percentage of salary and benefits to total operating expense has been between 51% and 55% since 1977 despite industry efforts to curtail increases in salary and wages. Recently the ratio has been closer to 51%. Supplies are the second biggest expense with averages around 17% of operating expenses for the past eight years. While insurance which includes malpractice insurance is not included in the quarterly detail, based on the fiscal year 2004 reports, it is about 1.57% of operating expense, which is slightly more than double the 2001 rate of .72%. The quarterly system collects data in these categories: salaries, benefits, supplies, depreciation, interest, bad debt and all other expenses. The year end reports collect additional detail and that data is available through year 2004.

Operating Expense Components

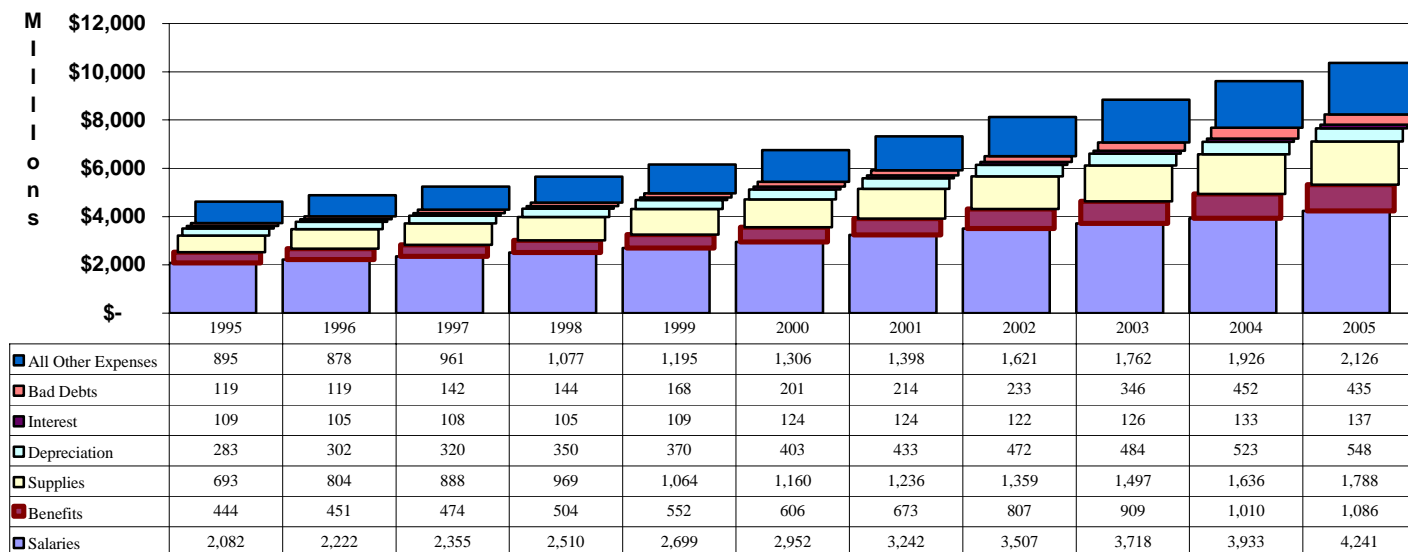


Chart: Operating expenses are now more than \$10 billion a year. The operating expenses have been growing at a steady rate over the years with salary and benefits being the main driver most of the years. Occasionally supplies, insurance or other category are additional drivers of increased expenses.

Salary & Benefits as a Percent of Total Operating Expense

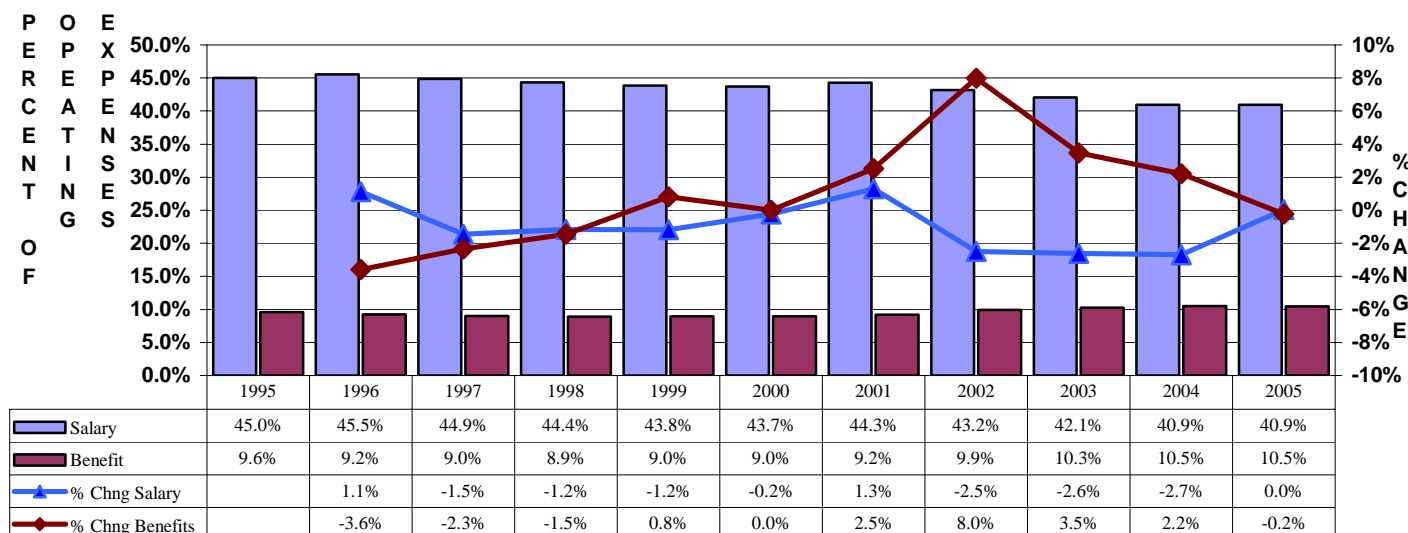


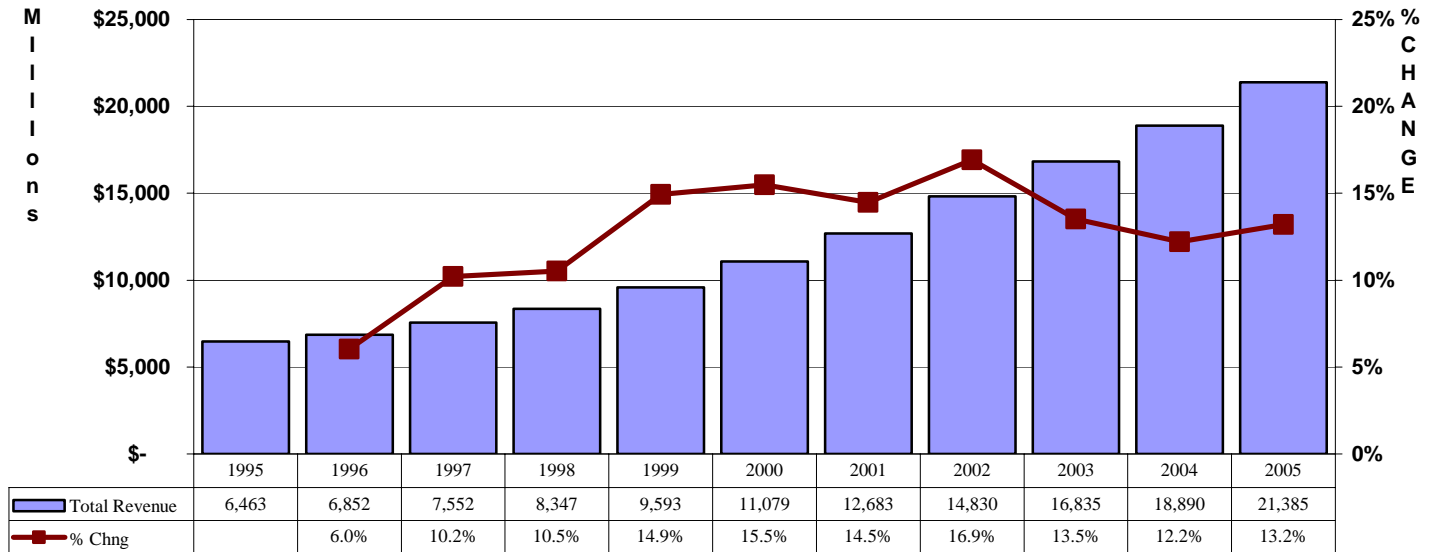
Chart: While Salary and Benefits are between 51 and 55% of operating expenses each year, the mix between the two has changed. In 1995 Salary was 45% of operating costs but in 2005 it was only 40.9%, a significant drop. However, benefits increased from 9.6% to 10.5% in the same time frame. Please see the operating expense topic for more information.

FINANCIAL INDICATORS

Total Patient Service Revenue

Total billed charges for patient services, which is identified as total patient service revenue or total revenue, increased by \$2.5 billion from \$18.9 billion to \$21.4 billion for the period ending December 31, 2005. The annual increase rate of 13.2% is similar to the past couple of years. The annual increase has been greater than \$2 billion each year for the past four years.

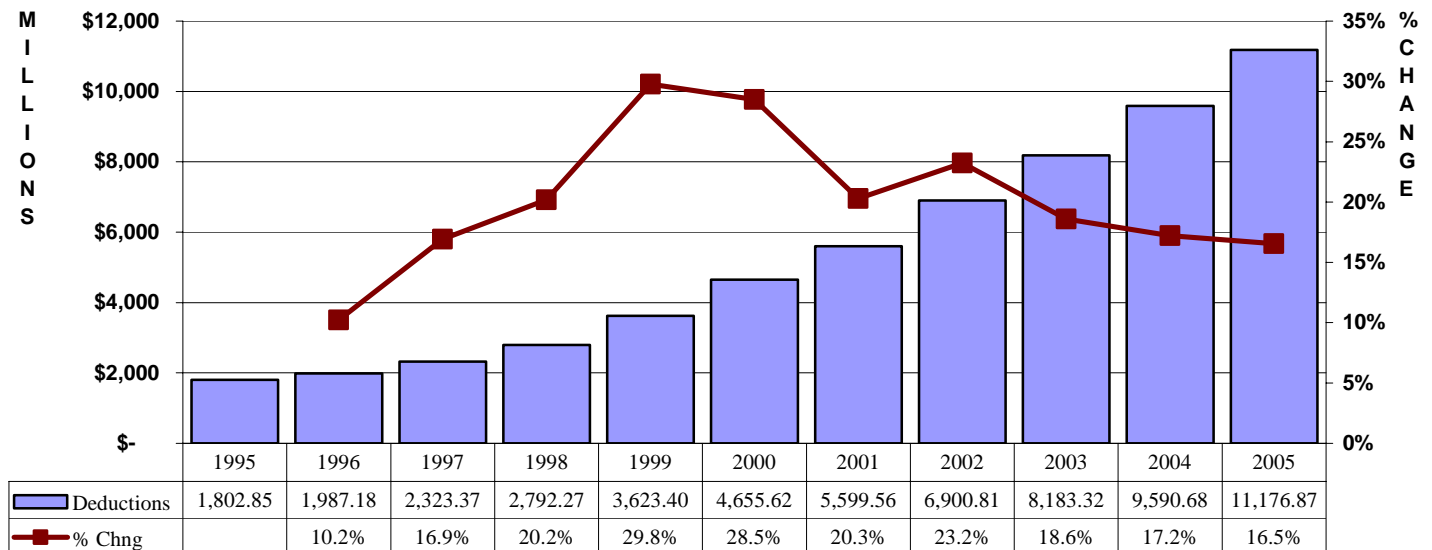
Total Patient Service Revenue



Total Deductions from Revenue

For the twelve months ended December 31, 2005 total deductions from revenue reached \$11.1 billion. This was an increase of \$1.6 billion, or 16.5% over the previous period ending December 31, 2004. Total deductions from revenue have been more than 50% of total patient service revenue for the last two years. Total Deductions include contractual adjustments and charity care.

Total Deductions from Revenue

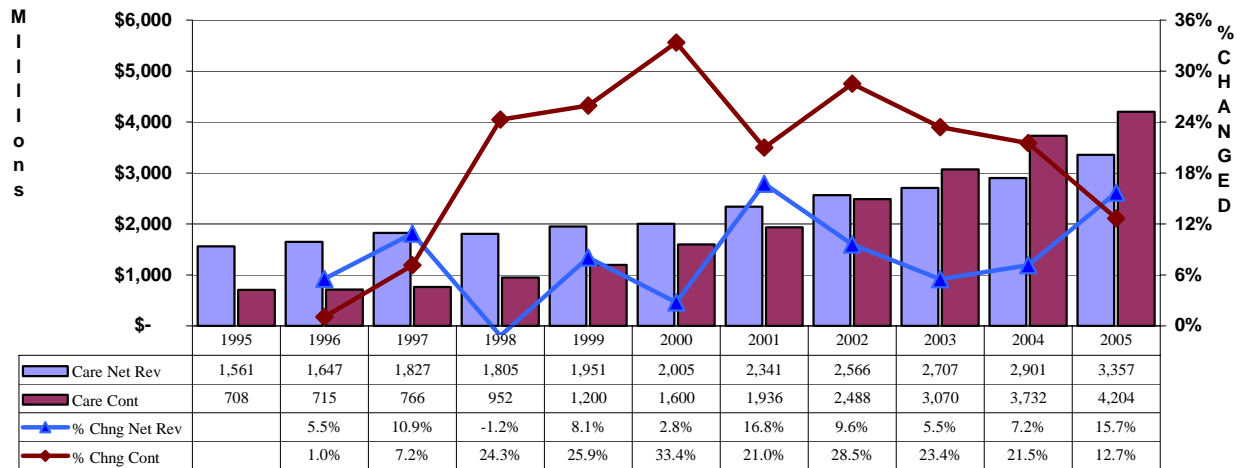


Contractual Adjustments

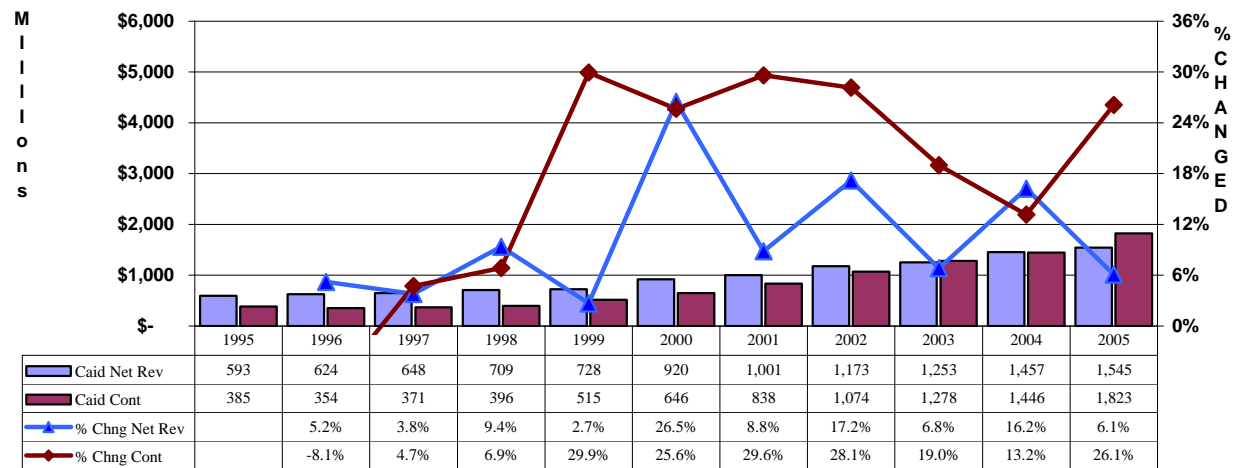
Contractuals which make up the most significant part of deductions from revenue, vary by payer. Below are three graphs, one for each payer, Medicare, Medicaid and Other. The three graphs are set up so you can see the relative size of the contractual adjustments and the net revenue by payer. The chart shows net revenue and contractuals and the percentage change for each over the prior year period. Other payer has the largest portion of net revenue, \$5.8 billion and deductions of \$4.6 billion. Medicare's net revenue of \$3.4 billion is much less than Other, however the contractuals are very close to Other at \$4.6 billion. Medicaid net revenue

was \$1.5 billion and deductions were \$1.8 billion. Based on the hospital's rate sheet or billed revenue, hospitals bill Medicare an average of \$2.25 for each dollar they receive, from Other payers an average \$1.79 and Medicaid on average \$2.18.

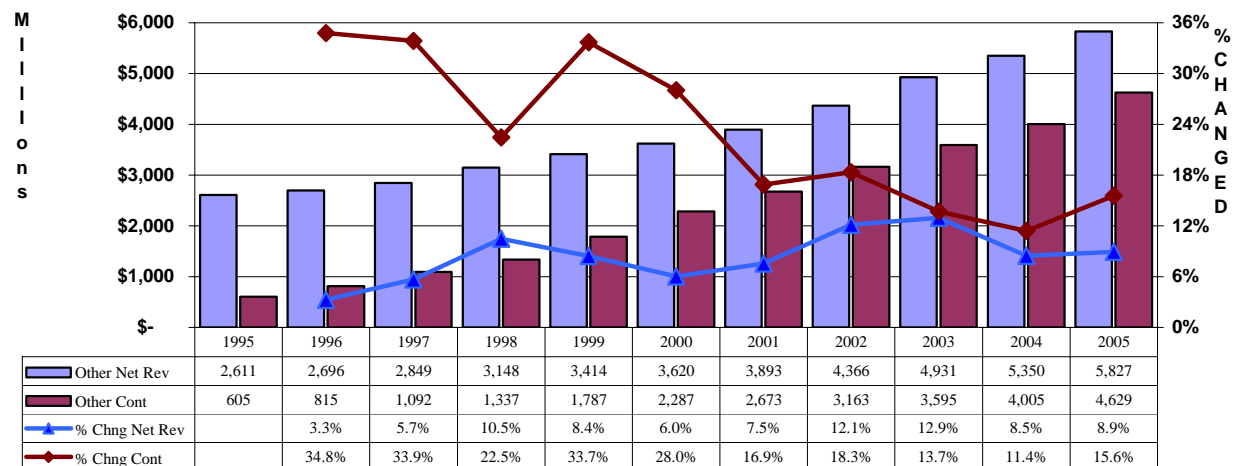
Medicare Contractuals



Medicaid Contractuals



Other Contractuals



Uncompensated Care

Uncompensated care is composed of charity care and bad debt expense. While charity care is part of the deductions from revenue category and bad debt is part of the operating expenses, they are similar. Each represents billed charges for hospital services that are not paid. Charity care represents charges that are not paid by patients who are **unable** to pay, while bad debt expense arises from charges that are not paid by patients who are **unwilling** to pay. During this cycle, charity care has grown by 27.7% bad debt has declined by 3.7%, for a total increase in uncompensated care of 11.2%.

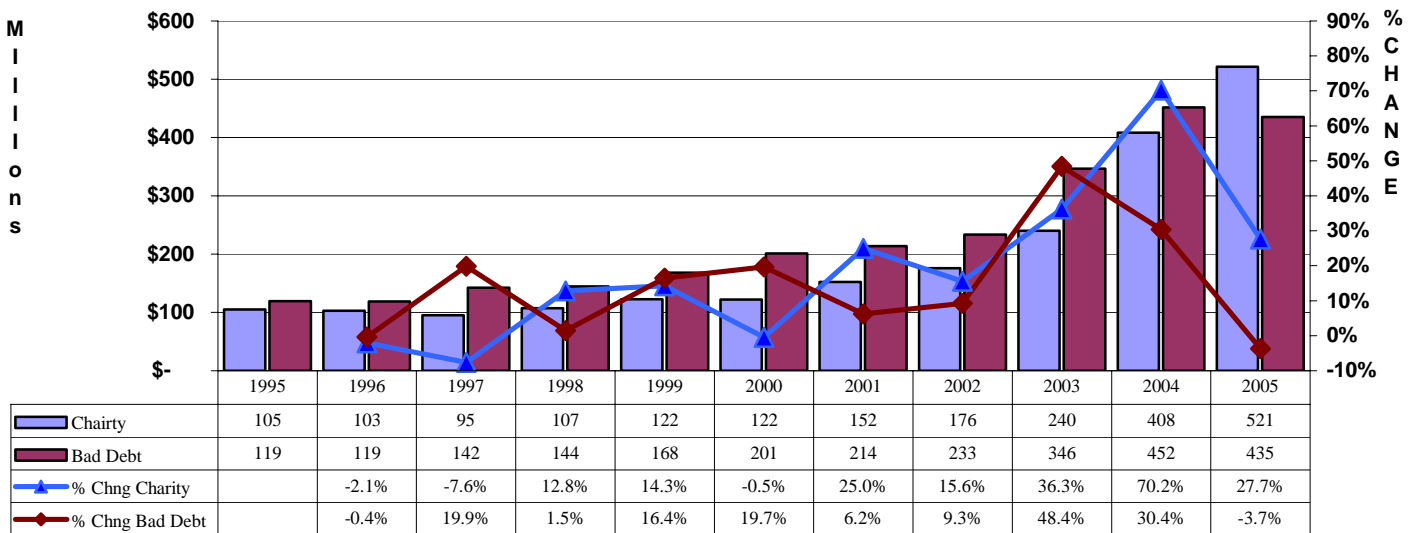
Charity

While charity care is only 2.44% of billed revenue, the dollar amount and percentage have been growing very rapidly during the past five years. During this period, charity care has increased 222%. The dollar amount has grown from \$122 million for 2000 to \$521 million for 2005.

Bad Debt

Over the past three years, the Bad Debt dollar amount has increased 11%. The dollar amount has grown from \$201.0 million in 2000 to \$435 million for 2005. The high mark was the period ending December 31, 2004 at \$452 million and the dollar amount declined in 2005 to \$435 million. Declines in the total dollar amount of Bad Debt are rare.

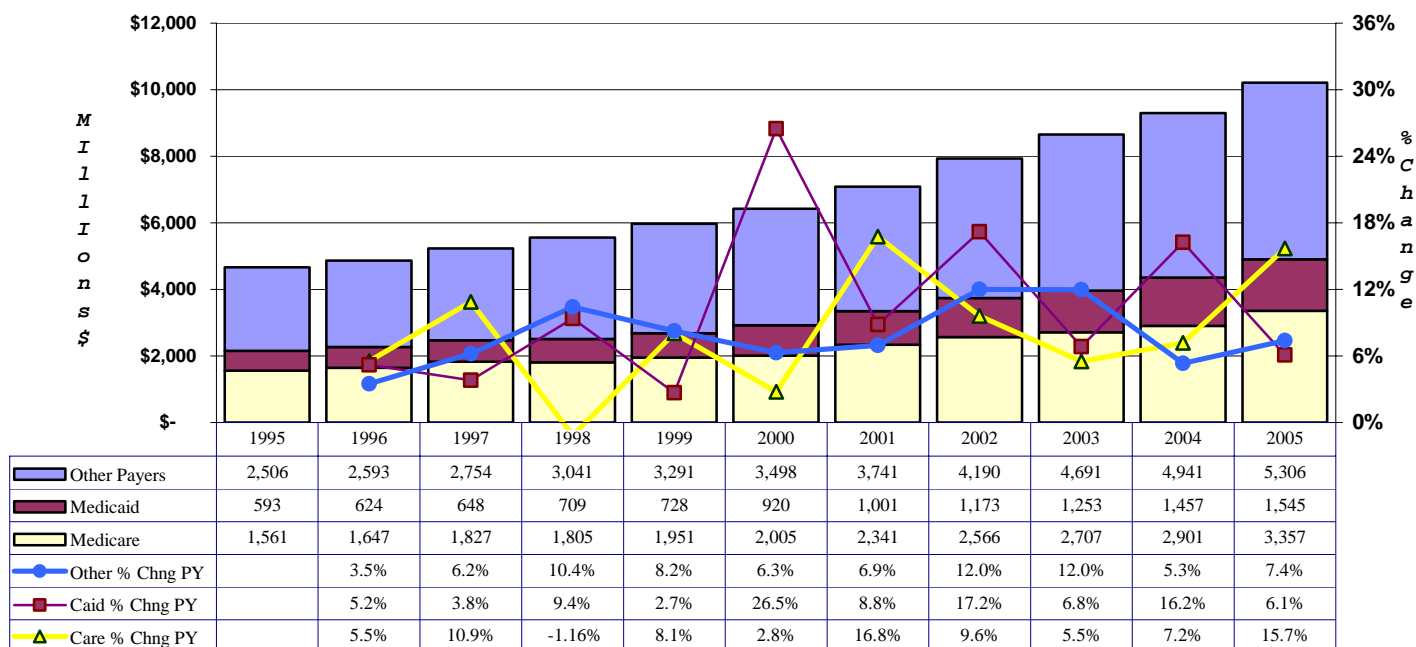
Charity and Bad Debt



Net Patient Services Revenue

During the twelve month period ended December 31, 2005 net patient service revenue grew by 9.8%, or \$908 million, from \$9.3 billion to \$10.2 billion. The percentage increase is the largest in four years. Net patient service revenue is defined as the amount of revenue actually realized by hospitals from patient based operations. When deductions from revenue grow more rapidly than total patient service revenue, the growth rate of net patient service revenue is less than the rate of increase for total patient service revenue. This condition has existed in every year since 1996. The percentage change by payer shows that Medicare had a 15.7% increase, Other had a 7.4% and Medicaid had a 6.1% increase over 2004. Because Medicare net patient revenue (NPR) grew 112% more than Other revenue, it increased its share of total NPR from 31.2% in 2004 to 32.9% in 2005.

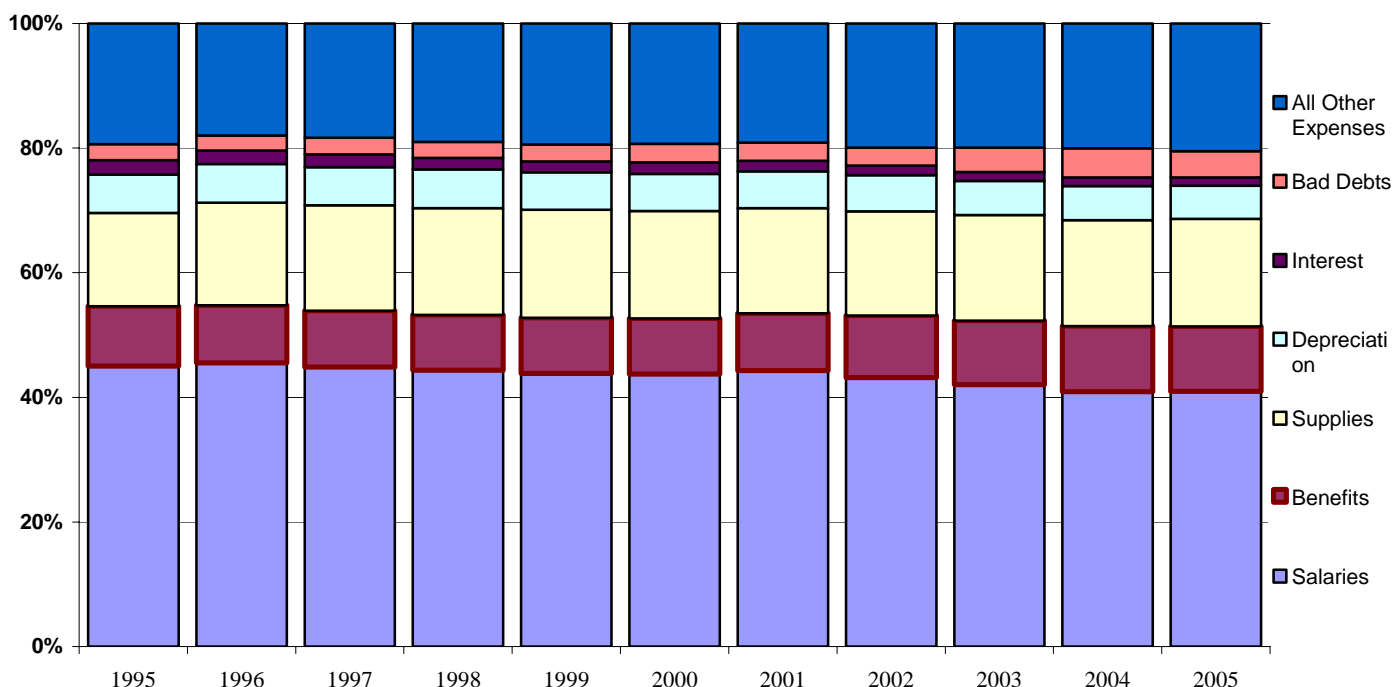
Net Patient Service Revenue by Payer



Operating Expenses

Growing by 7.8%, or \$748 million, operating expenses reached \$10.4 billion in the twelve month period ended December 31, 2005. This is the first year that operating expenses have been more than \$10 billion. It took only nine years for total operating expenses to double. Adjusted admissions only increased 26% during the same time period. Operating expenses are the costs of providing health care services to hospital patients. The 7.8% increase exceeded the 3.4% annual increase in the overall consumer price index and the 5.1% annual increase in the hospital services component of the index for the same time period. CPI information is at this link <http://ftp.bls.gov/pub/news.release/History/cpi.01182006.news>. The category with the largest increase between 2004 and 2005 within operating expense was supplies at 9.3%. The Supply portion of total expenses increased \$152 million dollars, to \$1.79 billion during the same time frame.

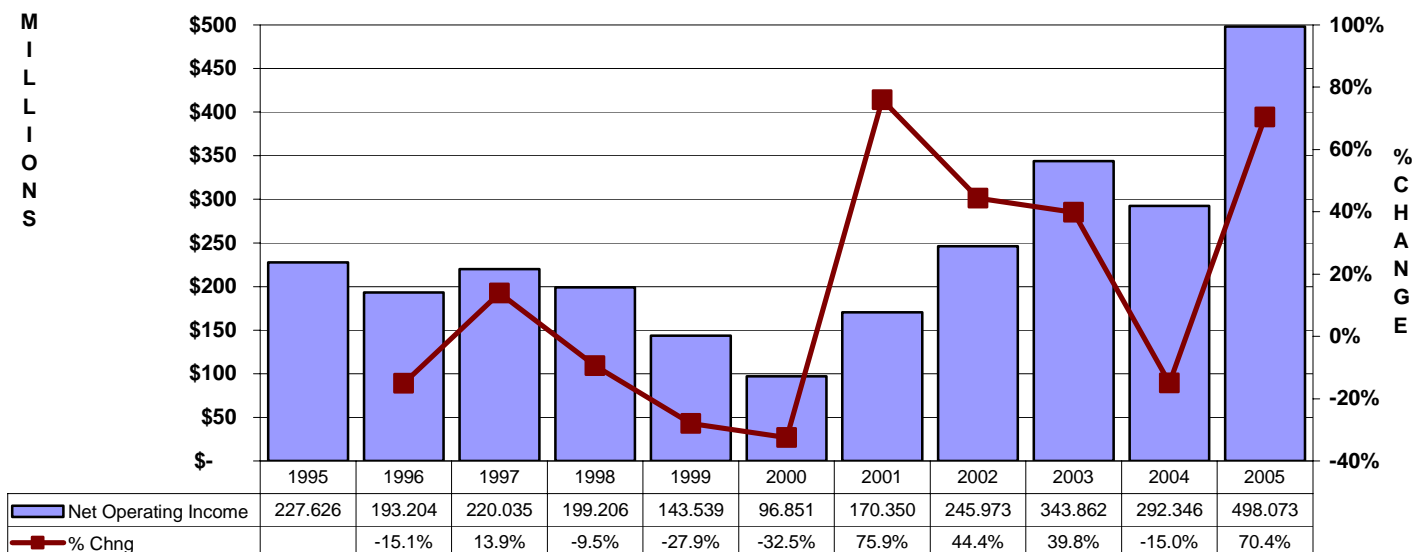
Operating Expense Percent by Type



Net Operating Income

During the four quarters ended December 31, 2005 net operating income advanced to \$498 million, which was 70.4% over the year ago level. Net operating income is volatile due to the large dollars that are involved in the calculation. A small change in the ratio of operating income, which grew 9.6% and operating expense, which grew 7.8%, caused a 70.4% change in net operating income.

Net Operating Income

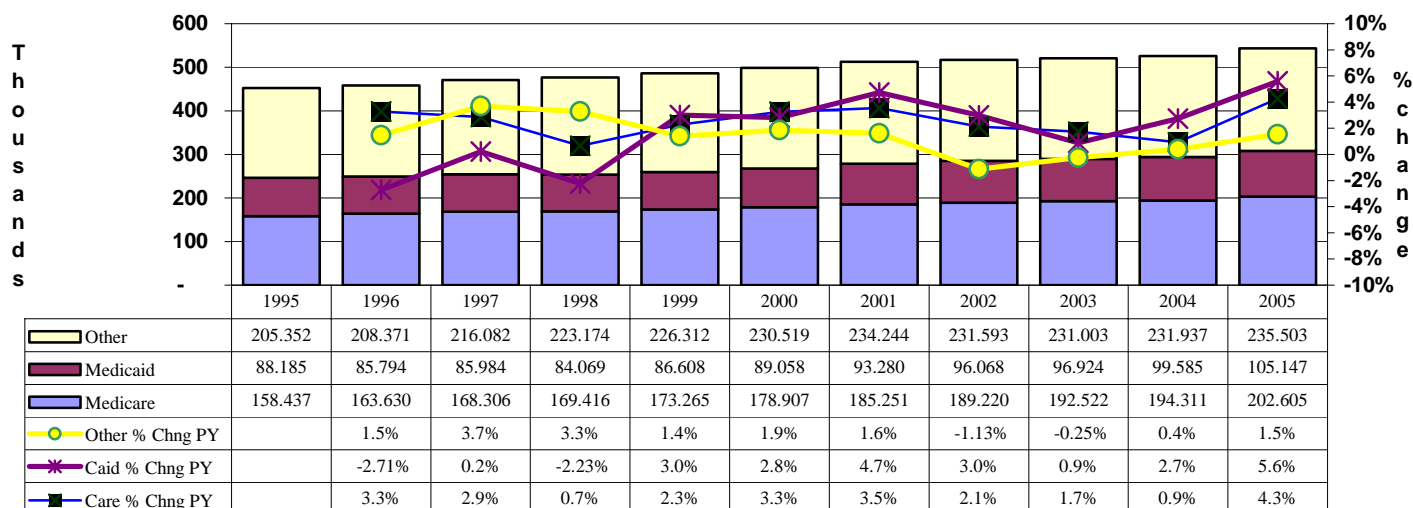


UTILIZATION INDICATORS

Discharges

Discharges and patient days are the primary indicators of inpatient activity. Discharges continued to grow, reaching a total of 543,255 discharges during 2005. This was a gain of 17,422 discharges, or 3.31%, over 2004. Medicare and Medicaid had significantly larger growth than Other, however Other did have its largest growth since the 2001-00 period.

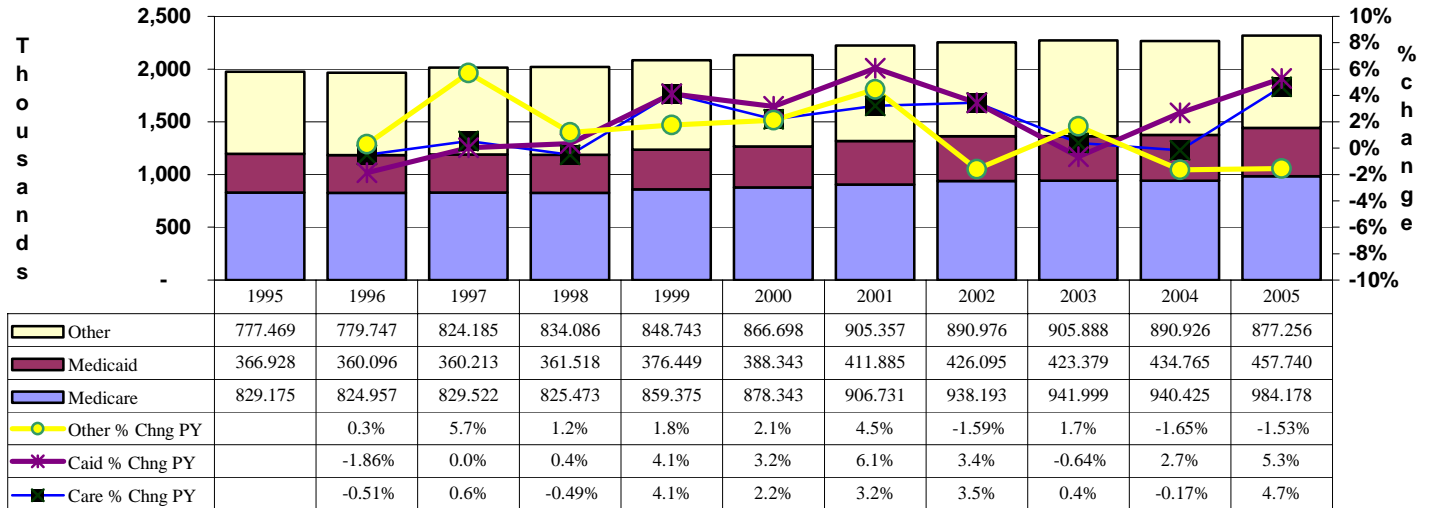
Discharges by Payer



Patient Days

Patient Days also continued to grow, reaching a total of 2,319,174 during 2005. This was a gain of 53,058 patient days, or 2.34%, over the corresponding year ago period. Medicare days grew 4.7%, Medicaid days grew 5.3% and Other days decreased 1.5% over that one year period. Other payer has fewer patient days in 2005 than it did in 2001.

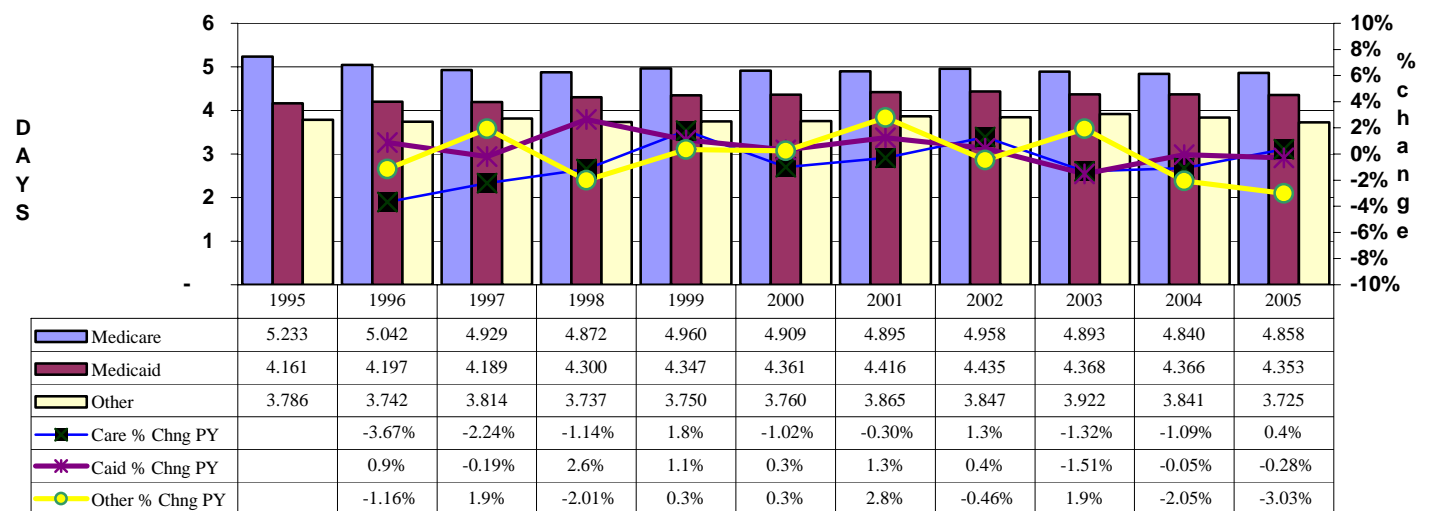
Patient Days by Payer



Length of Stay

Since the increase in discharges exceeded the increase of patient days, statewide average length of stay declined slightly to 4.27 days. Statewide average length of stay (ALOS) had remained in the range of 4.37 days to 4.24 days from calendar year 1995 through 2005. During the four quarters ended December 31, 2005 the average length of stay has declined by .04 days from the previous period ending December 31, 2004. In the latest period Medicare average length of stay was 4.86, Medicaid was 4.35 and Other was 3.73. Medicare ALOS was 11.6% higher than Medicaid and 30.0% higher than Other payer in 2005. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

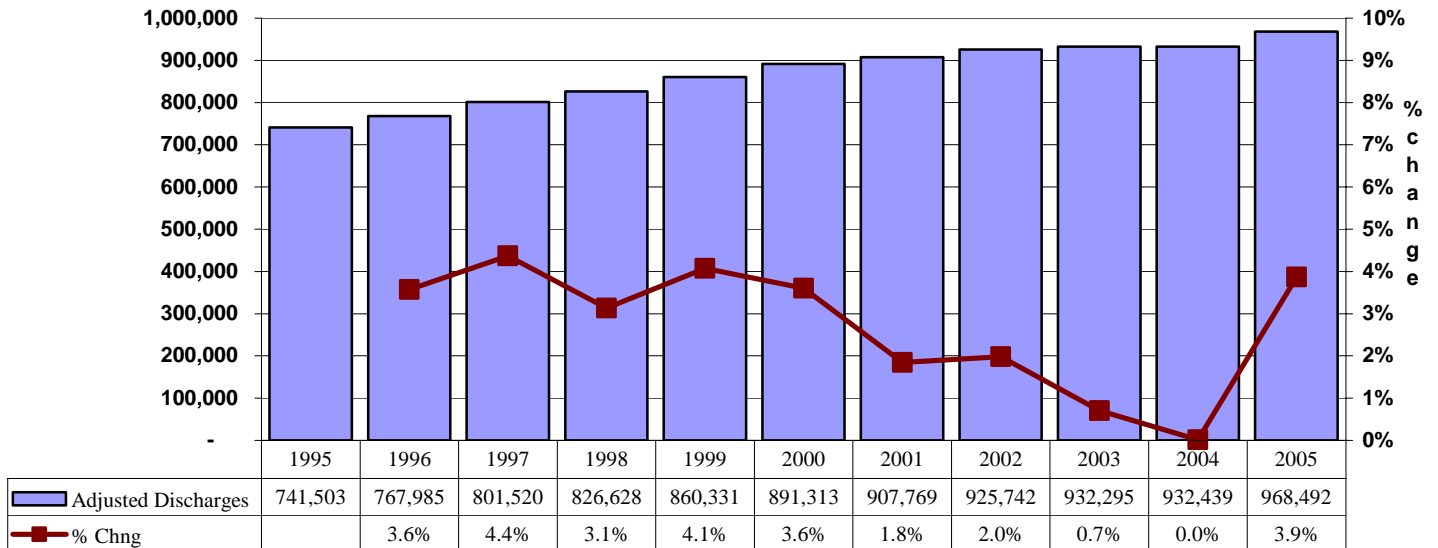
Length of Stay by Payer



Adjusted Discharges

Adjusted discharges reached a total of 968,492 in the four quarter period ended December 31, 2005. This was an increase of 36,053 adjusted discharges, or 3.9%, from the four quarter period ended December 31, 2004. This was the largest one year increase in adjusted discharges in over 10 years. Adjusted discharges were created as a proxy for total hospital volume since discharges only count inpatients. Adjusted discharges, within the quarterly system, are calculated by increasing discharges by the percent of inpatient revenue to total revenue.

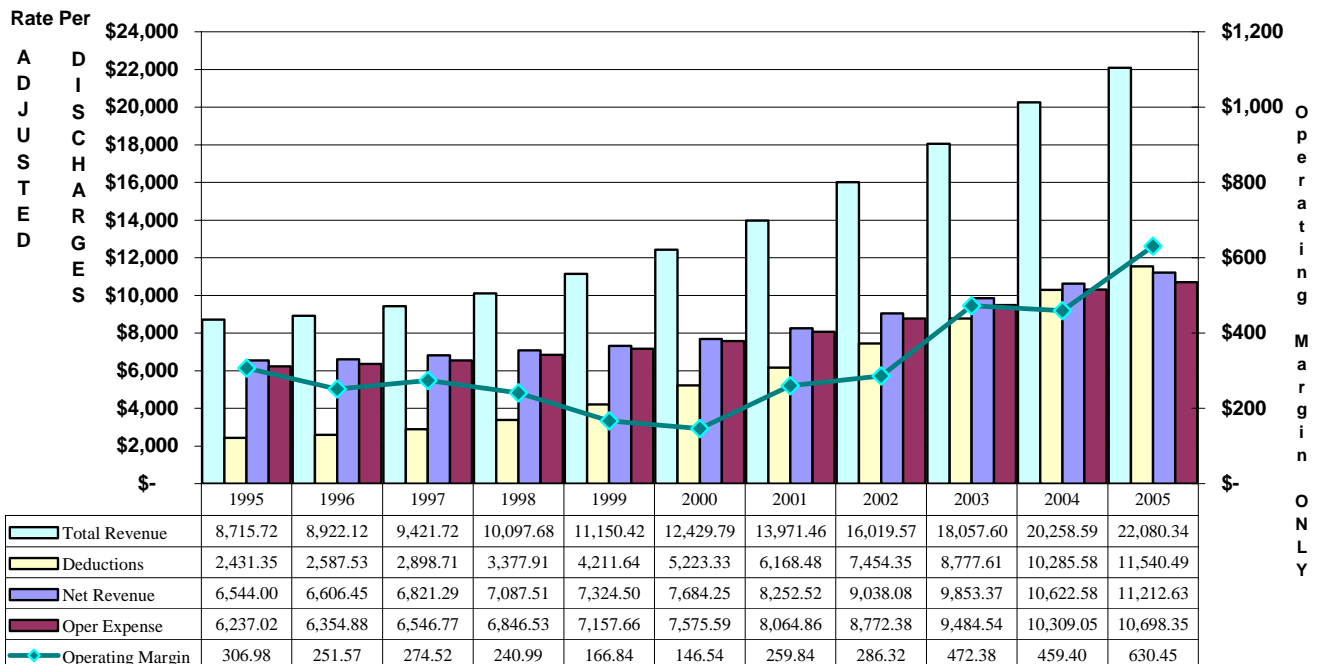
Adjusted Discharges



OPERATING INDICATORS

Rates per Adjusted Discharge

When you take the total dollar amounts for various categories and divide by the adjusted discharge count, you get an average rate per adjusted discharge. This formula removes volume fluctuation from the review and makes it easier to look at other factors. While the dollar amount of rates continues to rise each period, the percentage increase is on a slight downward swing, except for net profit which is currently on a rise. Note the continued large increase of deductions as it becomes a bigger number than net revenue. Total or billed revenue is becoming less relevant each year as it is now more than twice the actual dollar amount collected.



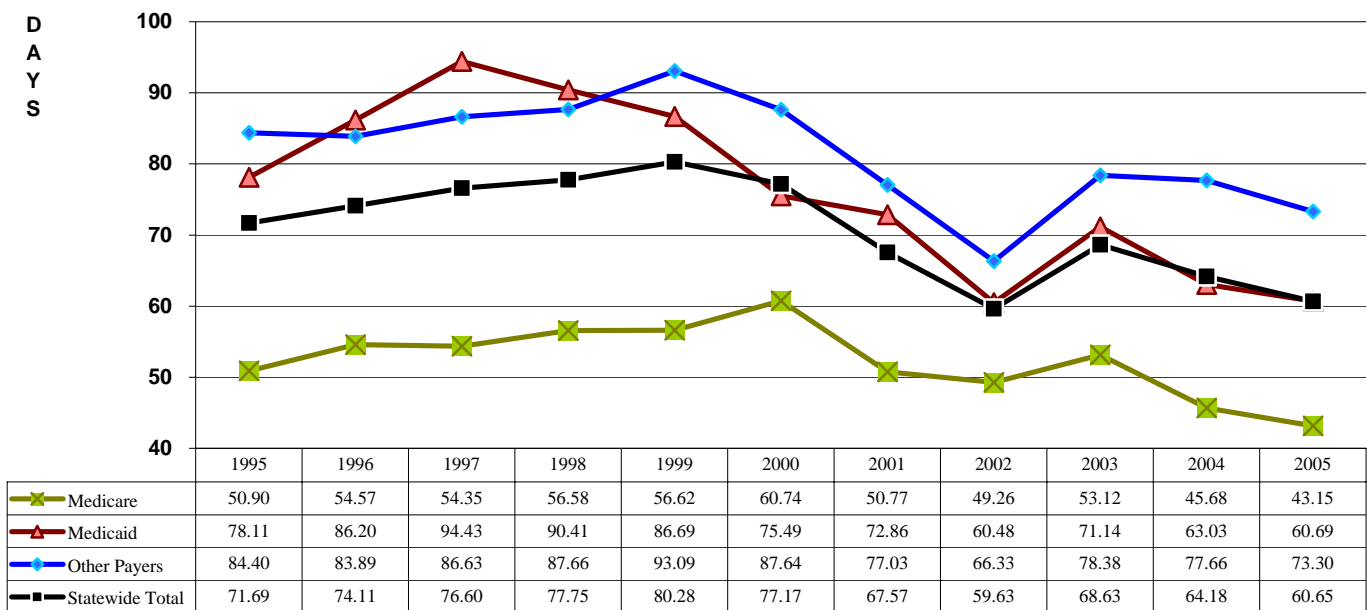
FINANCIAL RATIOS

The relationships between financial indicators are reflected by financial ratios. The financial ratios selected for this report are not all encompassing, but represent financial indicators that can be readily calculated from the data available through the quarterly reporting process as currently designed without requesting supplemental data from the reporting hospitals.

Days in Accounts Receivable

Accounts receivable is the largest item in the current assets portion of the balance sheet for most hospitals. Days in accounts receivable is a measure of how “current” this asset is. In this report days in accounts receivable is calculated on an annual gross basis. Shorter days or smaller numbers are more desirable. On a statewide basis accounts receivable averaged 60.7 days for the four quarter period ended December 31, 2005. This was a reduction of 3.5 days, or 5.5%, from the corresponding year earlier period. Medicare accounts receivable decreased by 2.6 days, or 5.5%, to 43.2 days. Accounts receivable for Medicaid dropped by 2.3 days, or 3.7%, to 60.7 days. A reduction of 4.3 days, or 5.6%, to an average of 73.3 days was also noted for Other payer groups.

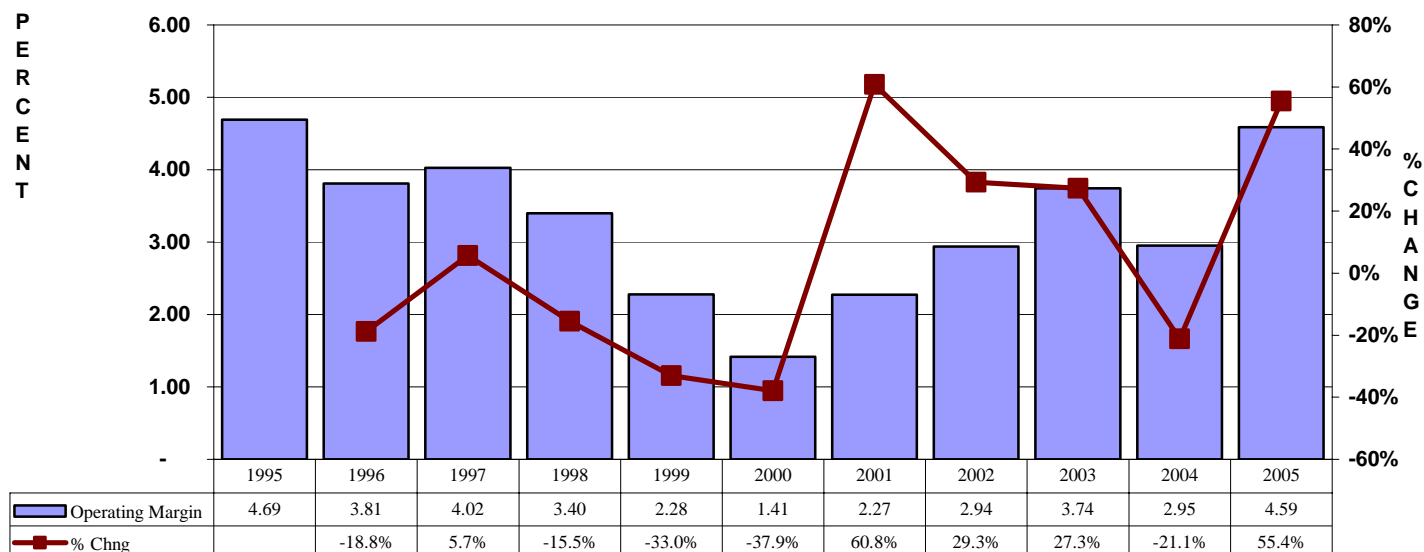
Days in Accounts Receivable by Payer



Operating Margin

During the twelve month period ended December 31, 2005 operating margin reached 4.3%, which was 30% above the year earlier level. This is the highest level since the year ending December 31, 1997. The low was 1.4% in December 30, 2000. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

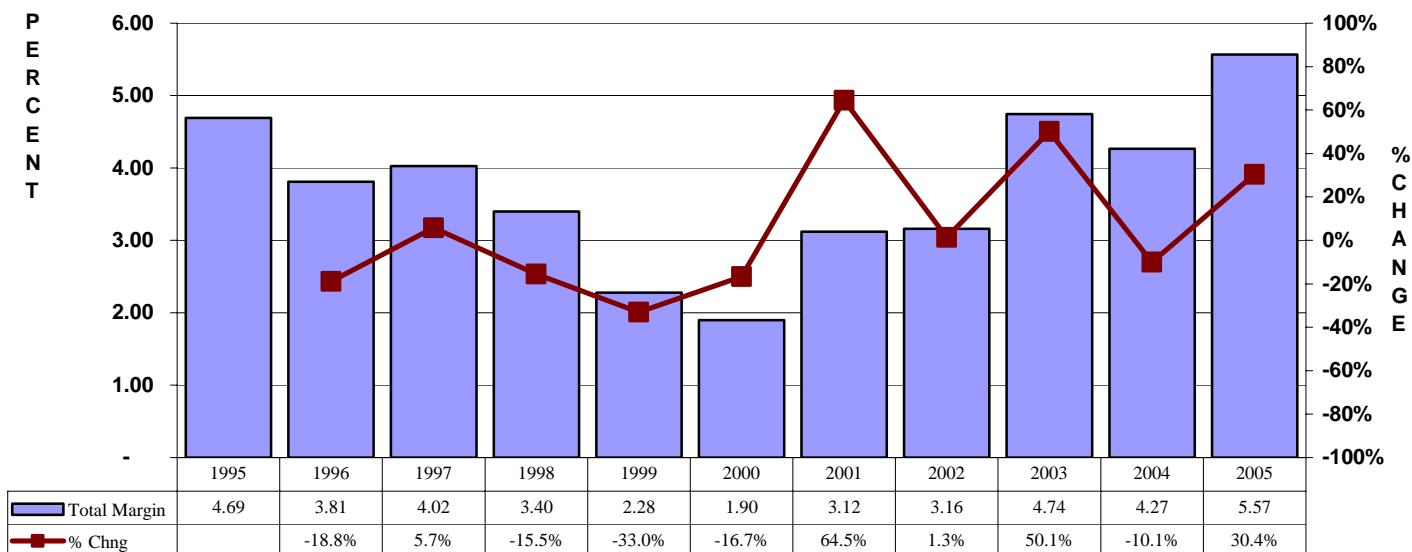
Operating Margin



Total Margin

During the twelve month period ended December 31, 2004 operating margin reached 5.6%, which was 30.4% above the year earlier level. The 5.6% has not been achieved in the past 10 years. The recent low of 1.9% was for the year 2000. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

Total Margin



Deductible Proportion

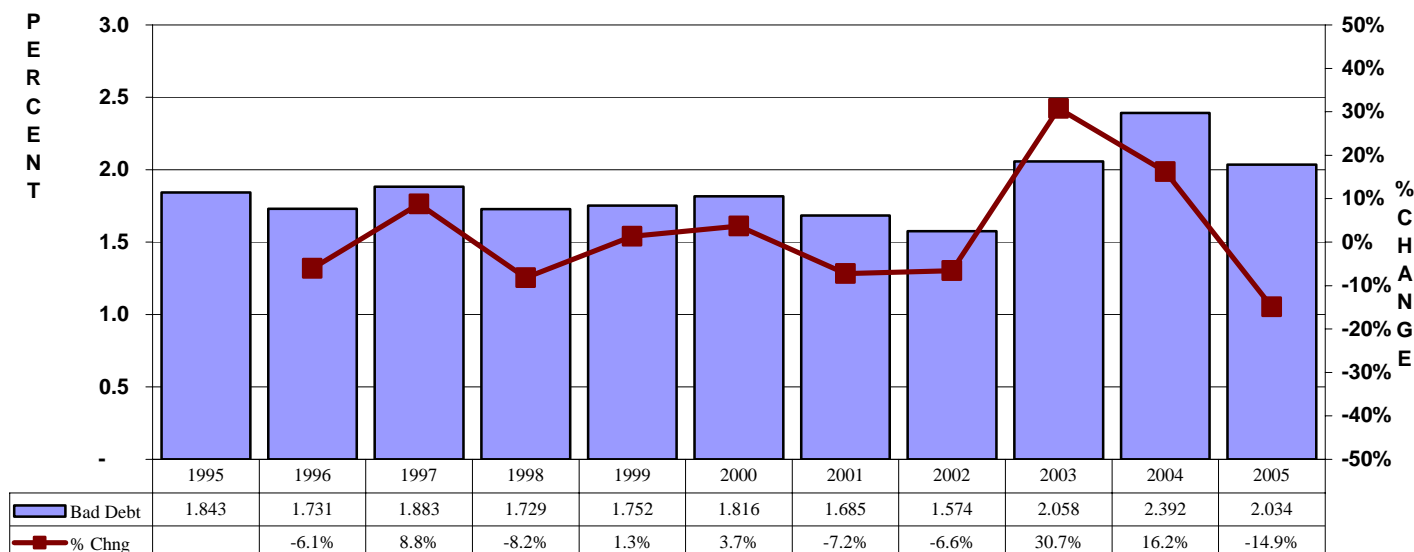
Uncompensated Care Proportion

The bad debt proportion, charity proportion, and total uncompensated care proportion, compare bad debt expense, charity care, and total uncompensated care to total patient service revenue. The total uncompensated care proportion reached 4.47%, which was an decline of 1.8% over the previous year because bad debt had an actual dollar decline.

Bad Debt

In the four quarter period ended December 31, 2005, the bad debt proportion reached 2.03%, which was an decrease of 15% from the previous year. This was the first decline in this ratio since 2002. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

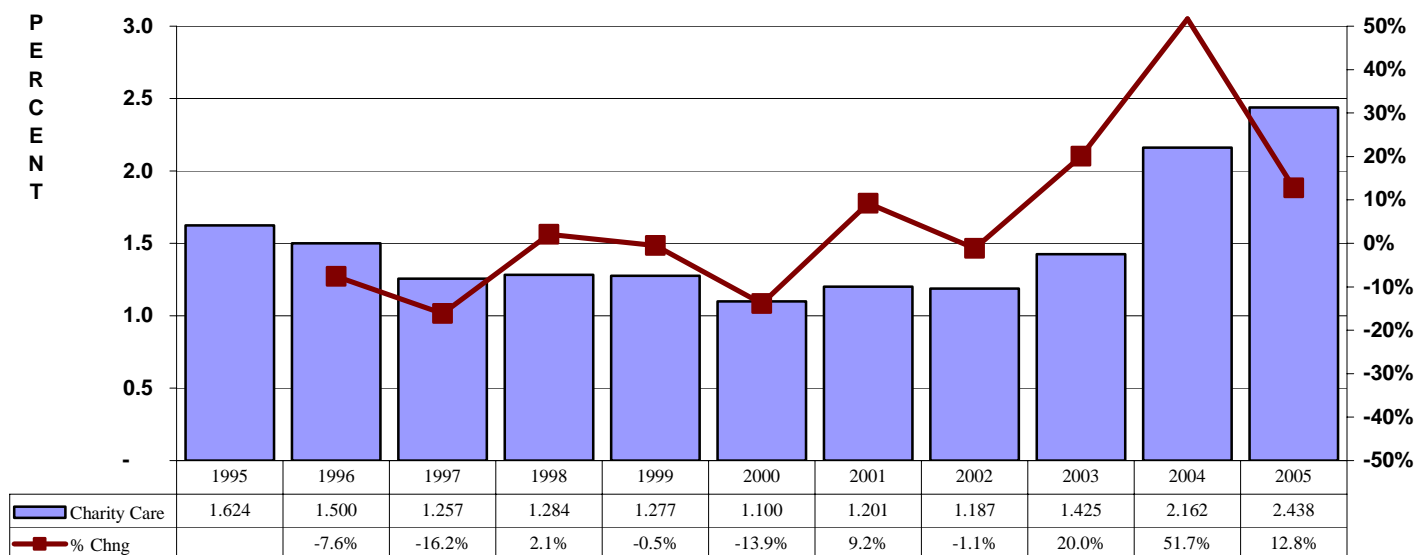
Bad Debt as a Percent of Total Revenue



Charity Care

The charity care proportion reached 2.44%, which was an increase of 12.8% over the previous year and was the highest noted since the beginning of our data. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

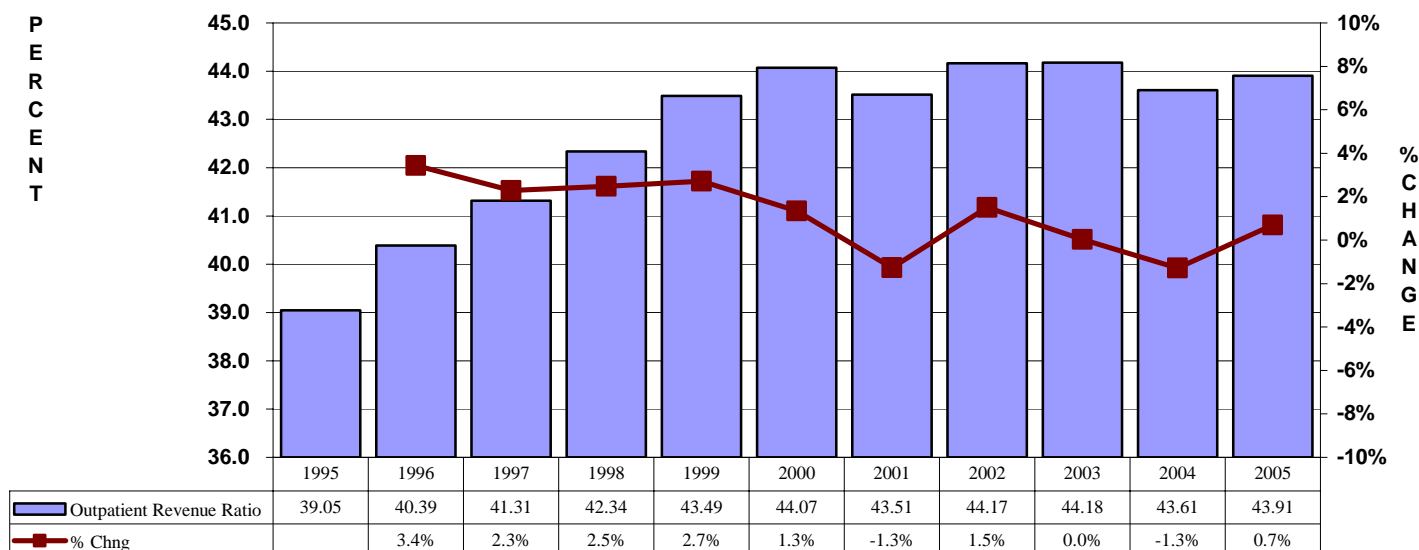
Charity Care as a Percent of Total Revenue



Inpatient and Outpatient Revenue

The outpatient revenue percentage is a way of looking at the relationship between inpatient and outpatient revenue. It is a rough indicator of the change in treatment locations. Between the annual periods ended December 31, 2004 and December 31, 2005 the outpatient revenue percentage increased from 43.2% to 43.9%, or 0.7%. As hospitals moved procedures from inpatient to outpatient setting over the years, the ratio has gone up dramatically. In 1987 the ratio was 24.2%. Please note the percentage change mark of 0.0% is in the middle of the chart so you can see the negative trend.

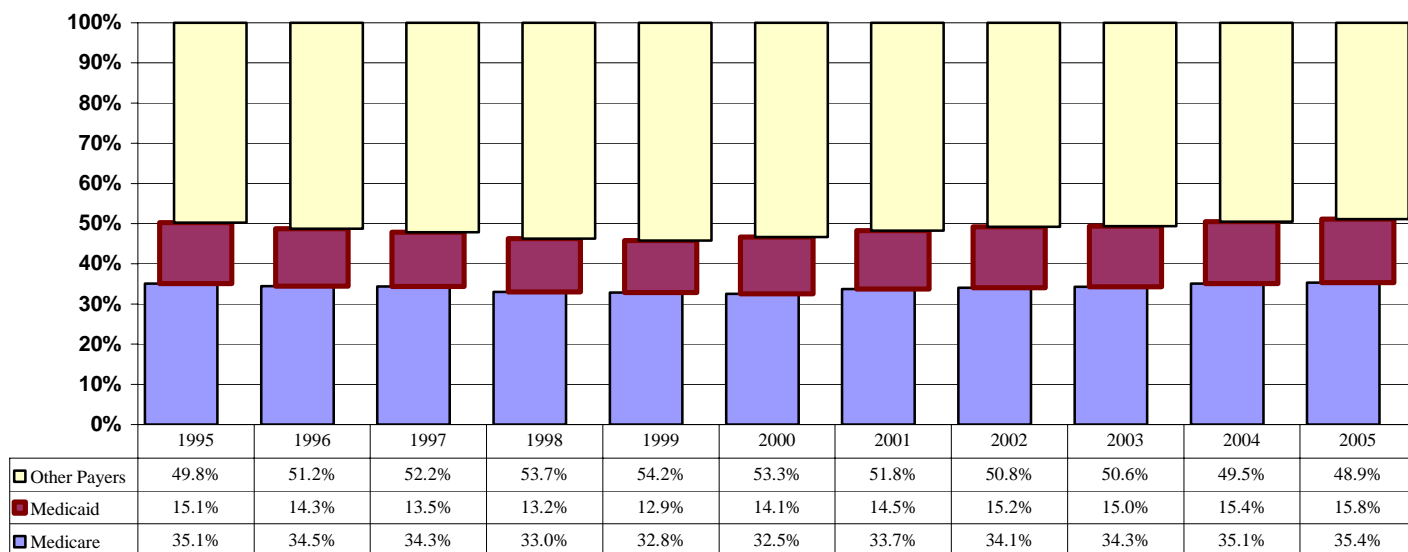
Outpatient Revenue as a percent of Total Revenue



Medicare and Medicaid Revenue

The Medicare billed revenue percentage and the Medicaid billed revenue percentage indicate the proportion of total hospital business that these programs represent. In the four quarter period ended December 31, 2005 the Medicare percentage was 35.4%, an increase of 0.8% over 2004, which continues an increase over each of the past five years. The Medicaid percentage was 15.8% which is a 2.5% increase from the previous period ending December 31, 2004. With 51.2% of total patient service revenue, the highest in the eleven year reviewed in this report, the Medicare and Medicaid programs have a major influence on the financial health of hospitals. Other payer revenue declined 1.2% from 49.5% during the period ending December 31, 2004 to 48.9% for the period ending December 31, 2005. Please see the net revenue graphs under contractual adjustments for more information.

Medicare and Medicaid Revenue proportion by Payer



Notes:**Information**

For more detailed information you can visit the Department of Health - Hospital and Patient Data web site at <http://www.doh.wa.gov/EHSPHL/hospdata> for a large variety of hospital data and reports. Included are hospital financial data and reports, hospital discharge data and reports, and Charity Care reports. Also included are Directory of Hospitals, CHARS Procedure Manual, *Accounting and Reporting Manual for Hospitals*, Charity Care reports and past *hospTRENDS*.

Your comments and suggestions for improvement would be greatly appreciated. Please let us know what you like or don't like about the content and presentation of the *hospTRENDS* report. Contact information is on the last page.

Background

All licensed hospitals in the State of Washington submit summary financial and utilization data to the Department of Health following each calendar quarter. Reported data are edited, summarized, and analyzed by Hospital and Patient Data Systems staff. Specific data elements are defined in the Department's *Accounting and Reporting Manual for Hospitals*. Utilizing these data, various financial and utilization rates and ratios are calculated to enhance the description of the financial condition of hospitals in the state. The purpose of this series of reports is to provide information describing emerging hospital utilization and financial trends to all concerned parties.

Rather than focusing on individual calendar quarters, the data in this report are aggregated into twelve month periods consisting of four calendar quarters each. This aggregation reduces the impact of seasonal fluctuations, which could distort actual trends occurring within the hospital industry.

The period covered by this report includes the four quarters of 2005. However, this preview is subject to change. The quarterly reports submitted by hospitals contain interim data which have not yet been subjected to audit review. Future adjustments and/or revisions as a result of both the hospital's internal accounting system review and the formal procedures of outside auditors may result in changes to previously submitted data. These future revisions will be reflected in the hospital's year-end reports. The year-end reports not only reflect audit adjustments but also provide substantially greater detail, which allows analysis of the information provided in greater depth.

HOSPITAL PERFORMANCE STATEWIDE	12 Mo. Ended Dec 31 2004	12 Mo. Ended Dec 31 2005	Total Change	Percent Change
Total Patient Revenue				
Inpatient	10,652,635,143	11,995,256,250	1,342,621,107	12.60%
Outpatient	8,237,273,039	9,389,389,315	1,152,116,276	13.99%
Total	18,889,908,182	21,384,645,565	2,494,737,383	13.21%
Medicare	6,632,918,500	7,560,696,990	927,778,490	13.99%
Medicaid	2,902,492,678	3,368,287,514	465,794,836	16.05%
Other	9,354,497,004	10,455,661,061	1,101,164,057	11.77%
Deductions From Revenue				
Contractual Adjustments				
Medicare	3,731,706,871	4,204,014,558	472,307,687	12.66%
Medicaid	1,445,686,176	1,823,017,042	377,330,866	26.10%
Other	4,004,957,150	4,628,516,342	623,559,192	15.57%
Total	9,182,350,197	10,655,547,942	1,473,197,745	16.04%
Charity	408,333,040	521,326,284	112,993,244	27.67%
Total	9,590,683,237	11,176,874,226	1,586,190,989	16.54%
Uncompensated Care				
Bad Debt	451,769,126	435,063,325	(16,705,801)	-3.70%
Charity	408,333,040	521,326,284	112,993,244	27.67%
Total	860,102,166	956,389,609	96,287,443	11.19%
Net Patient Revenue				
Medicare	2,901,211,629	3,356,682,432	455,470,803	15.70%
Medicaid	1,456,806,502	1,545,270,472	88,463,970	6.07%
Other	5,349,539,854	5,827,144,719	477,604,865	8.93%
Total	9,299,224,945	10,207,771,339	908,546,394	9.77%
Other Operating Revenue	605,684,083	651,575,366	45,891,283	7.58%
Total Operating Revenue	9,904,909,028	10,859,346,705	954,437,677	9.64%
Total Operating Expenses	9,612,562,750	10,361,274,133	748,711,383	7.79%
Net Operating Income	292,346,278	498,072,572	205,726,294	70.37%
Non-Operating Income	116,103,232	95,303,123	(20,800,109)	-17.92%
Tax Revenue	19,915,866	17,211,923	(2,703,943)	-13.58%
Net Total Income	428,365,376	610,587,618	182,222,242	42.54%
Gross Accounts Receivable				
Medicare	830,070,517	893,817,440	63,746,923	7.68%
Medicaid	501,252,436	560,065,157	58,812,721	11.73%
Other	1,990,453,137	2,099,770,396	109,317,259	5.49%
Total	3,321,776,090	3,553,652,993	231,876,903	6.98%
Days in Accounts Receivable				
Medicare	45.7	43.1	(2.5)	-5.53%
Medicaid	63.0	60.7	(2.3)	-3.72%
Other Payers	77.7	73.3	(4.4)	-5.62%
Statewide Total	64.2	60.7	(3.5)	-5.50%
Utilization				
Discharges	525,833	543,255	17,422	3.31%
Patient Days	2,266,116	2,319,174	53,058	2.34%
Length of Stay	4.31	4.27	(0.04)	-0.94%
Adjusted Discharges	932,439	968,492	36,053	3.87%
Rates per Adjusted Discharge				
Total Revenue	20,258.59	22,080.34	1,821.75	8.99%
Deductions	10,285.58	11,540.49	1,254.90	12.20%
Net Revenue	10,622.58	11,212.63	590.05	5.55%
Operating Expense	10,309.05	10,698.35	389.30	3.78%
Net Margin	459.40	630.45	171.05	37.23%
Financial Ratios				
Operating Margin	2.95	4.59	1.64	55.40%
Total Margin	4.27	5.57	1.30	30.44%
Deductible Proportion	50.77	52.27	1.49	2.94%
Contractual Proportion - Total	48.61	49.83	1.22	2.51%
Contractual Proportion - Medicare	56.26	55.60	(0.66)	-1.17%
Contractual Proportion - Medicaid	49.81	54.12	4.31	8.66%
Contractual Proportion - Other	42.81	44.27	1.45	3.40%
Bad Debt Proportion	2.39	2.03	(0.36)	-14.93%
Charity Proportion	2.16	2.44	0.28	12.78%
Uncompensated Care Proportion	4.55	4.47	(0.08)	-1.78%
Total Revenue/Inpatient Revenue	1.77	1.78	0.01	0.54%
Outpatient Revenue Percent	43.61	43.91	0.30	0.69%
Medicare Revenue Percent	35.11	35.36	0.24	0.69%
Medicaid Revenue Percent	15.37	15.75	0.39	2.51%

hospTRENDS

Washington State

Community Hospital Financial and Utilization Trend Update
Quarter Ended December 31, 2005

For additional information, comments, and suggestions,
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